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BY ELECTRONIC MAIL, FAX AND FEDEX

James P. Mayer
Executive Director
Little Hoover Commission
925 L Street, Suite 805
Sacramento, CA 95814

Re: Inquiry re Governor's Energy Agency Reorganization Plan

Dear Mr. Mayer:

This letter responds to your inquiry dated May 31, 2005, and supplements our letter sent to you yesterday. Our June 22 letter addressed the Governor's Energy Agency Reorganization Plan, which the Governor submitted for review in May (and which was the subject of your letter). We have since learned that the Governor submitted a revised draft on June 13. Assuming that the June 13 draft is the proper vehicle for consideration under the reorganization act (see Gov. Code, §§ 8523, 12080 et seq.; see also Withdrawal by Governor of Item in a Reorganization Plan, Cal. Atty. Gen., Indexed Letter, No. IL 69-88 (April 22, 1969)), we submit this supplemental analysis of the issues you asked us to review. For clarity, we hereafter refer to the two documents submitted by the Governor as the "May Draft" and the "June Draft"

On behalf of the Milton Marks Commission on California State Government Organization and Economy, you asked whether changes proposed by the Governor's Energy Agency Reorganization Plan to move certain functions of the California Public Utilities Commission to the California Energy Commission or the proposed Department of Energy may be accomplished pursuant to the reorganization process established in Government Code section 12080 et seq.[1]

The California Public Utilities Commission (CPUC) is in pertinent part a creature of the California Constitution, and the Constitution confers on the CPUC the authority to set rates for

[1] Unless otherwise indicated, all statutory references herein are to the Government Code.

public utilities. Accordingly, the proposals that involve transferring rate-making functions from the CPUC to the California Energy Commission or the proposed Department of Energy exceed the scope of the reorganization statute. Other proposed changes do not interfere with the CPUC's rate-making authority, and are within the authority of the reorganization statute. Of the proposals in the June Draft analyzed below, we found that half satisfy the reorganization statute and half do not.

ANALYSIS

The Milton Marks "Little Hoover" Commission on California State Government Organization and Economy (Commission) is charged with promoting economy, efficiency, and improved service in state government agencies. (Gov. Code, §§ 8501-8542; see *State Bd. of Education v. Honig* (1993) 13 Cal.App.4th 720, 738, fn. 8; *Commission on Cal. State Gov. Org. & Econ. v. Fair Political Practices Com.* (1977) 75 Cal.App.3d 716, 720-722.) Pursuant to its authority under section 8523, the Commission is currently reviewing the Governor's Energy Agency Reorganization Plan, a revised version of which was submitted to the Legislature on June 13, 2005 (June Draft). Among other things, the June Draft proposes to create a Department of Energy and to transfer certain functions now performed by the CPUC to the California Energy Commission or the new Department of Energy. You have asked whether these functions may be so transferred, given the limitations of the reorganization statute, section 12080 et seq.[2] Though the answer is not free from doubt, we conclude that the reorganization statute cannot be used to transfer to other agencies functions intertwined with and required for the meaningful performance of the rate-making function conferred on the CPUC by article XII of the California Constitution.[3] (Gov. Code, § 12080.4, subd. (e).)

The reorganization statute requires the Governor, from time to time, to examine the organization of all agencies and determine what changes are necessary to accomplish several purposes set out in the statute. (Gov. Code, § 12080.1.) If the Governor finds that reorganization is in the public interest, the statute requires that he or she prepare a reorganization plan and

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[2] We have not been asked, and therefore do not address, either the June Draft's other proposals to transfer functions from other agencies to the Department of Energy or how the proposals considered herein might affect a transfer of functions from other agencies.

[3] We use the phrase "functions intertwined with and required for the meaningful performance of the rate-making function" as shorthand for the well-established principle of statutory construction that powers expressly granted must be construed to include the exercise of such additional powers necessary for the due and efficient administration of those powers, or as may fairly be implied from those powers. (See *Calfarm Ins. Co. v. Deukmejian* (1989) 48 Cal.3d 805, 824.)

deliver it to the Legislature. (Gov. Code, § 12080.2.) Section 12080.3 specifies the required contents of the reorganization plan. Section 12080.4 specifies what cannot be included in a reorganization plan. Germane to the question you have asked this office to address is subdivision (e), which provides:

> "No reorganization plan shall provide for, and no reorganization under this article shall have the effect of:
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> "(e) Abolishing any agency created by the California Constitution, or abolishing or transferring to the jurisdiction and control of any other agency any function conferred by the California Constitution on an agency created by that Constitution."

The CPUC is an agency created by the California Constitution.[4] (Cal. Const., art. XII, § 1; see *California Motor Transport Co. v. Railroad Commission* (1947) 30 Cal.2d 184, 188.) Under the above quoted section, the question you have asked turns on whether the functions the June Draft proposes to transfer from the CPUC to the new Department of Energy or the California Energy Commission are constitutionally conferred. If so, these functions cannot be transferred by means of the reorganization statute; if not, they can be transferred to the jurisdiction and control of other agencies through the reorganization process.

Article XII, section 6, of the California Constitution provides that the CPUC "may fix rates, establish rules, examine records, issue subpenas, administer oaths, take testimony, punish for contempt, and prescribe a uniform system of accounts for all public utilities subject to its jurisdiction." This rate-making authority has been broadly construed to include "the duty of supervising and regulating public utility services and rates." (*California Motor Transport Co. v. Railroad Commission, supra*, 30 Cal.2d 184, 188.) The powers available to the CPUC to carry out its constitutional duties have been interpreted to have similar breadth. (*Ibid.*; *People v. Western Air Lines, Inc.* (1954) 42 Cal.2d 621, 634.)

Article XII, section 3, of the California Constitution provides in pertinent part that: "Private corporations and persons that own, operate, control or manage . . . the production, generation, transmission, or furnishing of heat, light, water, power . . . directly or indirectly to or for the public . . . are public utilities subject to control by the Legislature. . . ."

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[4] The CPUC also meets the definition of an "agency" in the reorganization statute: it is a commission in the executive branch of state government, the primary function of which is not to serve the Legislature or the judicial branch, and it is not administered by an elective officer. (Gov. Code, § 12080, subd. (a).)

Thus, the CPUC has broad constitutional authority to fix the rates for energy utilities. Under section 12080.4, subdivision (e), transfer of rate-making functions cannot be accomplished through a reorganization. What comprises the rate-making function, however, and whether any of the functions the June Draft seeks to transfer come within it, are questions of first impression for which there is no bright-line rule. On the one hand, it is well-established that the rate-making function includes not just the power expressly granted to set rates, but the exercise of such additional powers necessary for the due and efficient administration of those powers, or as may fairly be implied from those powers. (See *Calfarm Ins. Co. v. Deukmejian* (1989) 48 Cal.3d 805, 824.) Statutory authority must be so construed to achieve its object. (*Dickey v. Raisin Proration Zone* (1944) 24 Cal.3d 796, 810.) On the other hand, the CPUC's authority to set rates does not extend to every matter that might conceivably affect retail rates. For example, the CPUC is not free to relieve utilities subject to its regulation from the regulations of other agencies that are generally applicable to utilities and other businesses in the state, even though other regulations may cause utilities to incur costs that might affect rates. (See *Orange County Air Pollution Control Dist. v. Public Utilities Commission* (1971) 4 Cal.3d 945, 953-54.) Also, the CPUC sometimes shares responsibility with other agencies for certain aspects of utility regulation that do not directly address cost recovery or rate making. (See *County of Sonoma v. State Energy Resources Conservation & Development Com. (County of Sonoma)* (1985) 40 Cal.3d 361, 364-365 & fn.3 [noting that CPUC cannot grant a certificate of public convenience and necessity for siting a thermal power plant until California Energy Commission issues certificate and that the latter's determination of matters in Public Utility Code section 1001 (now, section 1002) is conclusive on the CPUC].) Accordingly, there is some regulation that may indirectly affect rates which does not intrude on the constitutional rate-making authority of the CPUC. What the permissible scope of that authority might be, however, has not been tested. In arriving at a reasonable standard to evaluate the June Draft in response to your inquiry, we have also taken into account that the reorganization statute not only prohibits the transfer of a constitutional function to another agency's jurisdiction, but also prohibits transfer of the control of that function to another agency. (Gov. Code, § 12080.4, subd. (e).)

Because the courts have broadly interpreted the rate-making authority of the CPUC in general, because rules of statutory construction hold that functions implied in, or necessary to the exercise of, express statutory authority are included in the authority conferred, and because the reorganization statute restricts the transfer of constitutionally conferred functions to the jurisdiction and control of another agency, we conclude that the CPUC's rate-making function should be construed to comprise functions implied in, or necessary to the exercise of, the California Constitution's express grant of rate-making authority to the CPUC, and that such functions cannot be transferred to another agency under the authority of the reorganization statute. This is the legal standard we apply below to review the June Draft's proposals respecting the CPUC.

Review of the June Draft[5] reveals the following proposed transfers of five functions currently performed by the CPUC. Our analysis of the question presented with respect to these proposed transfers immediately follows the description of each proposed statutory amendment. For clarity, we note that the June Draft differs from the May Draft in the following respects: the amendment to Public Utilities Code section 335, subdivision (f) in the May Draft is not in the June Draft and therefore is not discussed below; the amendment to Public Utilities Code section 464, subdivision (b) in the May Draft is altered in the June Draft so that it does not take any function from the CPUC and therefore is not discussed below; and the June Draft includes two new proposals (not in the May Draft) to amend Public Utilities Code section 399.25, subdivisions (a) and (b), which are discussed below. The proposals in the May Draft with respect to Public Utilities Code sections 365, subdivision (a), and 1001, subdivisions (b) and (c), are in the June Draft as revised proposals, and are discussed below.

1. June Draft Amendments to Public Utilities Code section 365, subdivision (a).

This proposal (see June Draft at p. 183) would give the Department of Energy's Office of Energy Market Oversight (OEMO) shared responsibility with the CPUC for participating "fully in all proceedings before the Federal Energy Regulatory Commission in connection with the Independent System Operator and the independent Power Exchange," and encouraging "the Federal Energy Regulatory Commission to adopt protocols and procedures that strengthen the reliability of the interconnected transmission grid, encourage all publicly owned utilities in California to become full participants, and maximize enforceability of such protocols and procedures by all market participants." This June Draft proposal differs from a similar proposal in the May Draft by giving the OEMO shared, rather than exclusive authority, to participate in the referenced FERC proceedings.

The CPUC's authority to participate in FERC proceedings as the representative of California consumers is not a function explicitly given to the CPUC by the Constitution. However, some opportunity and responsibility to represent California consumers before FERC is, in our view, necessary to the meaningful exercise of the CPUC's rate-making authority. With very limited exceptions, under the federal "filed rate doctrine," wholesale rates set at FERC are directly passed through to retail rates and ratepayers. (*See Nantahala Power & Light Co. v. Thornburg* (1986) 476 U.S. 953; see also *Pacific Gas & Elec. Co. v. Lynch* (N.D. Cal. 2002) 216 F.Supp.2d 1016.) Due to the ongoing expansion of FERC authority, it is increasingly the case that determination of wholesale rates is virtually tantamount to the setting of retail rates. Thus, one of the ways that the CPUC "sets" retail rates is by participating in rate-making and rate

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[5] The June Draft is found at http://www.leginfo.ca.gov/pub/bill/asm/ab_0001-0050/grp_3_bill_20050613_introduced.pdf.

design proceedings at FERC. For this reason, the Federal Power Act gives state public utilities commissions standing to participate in its wholesale rate-making proceedings. (See, e.g., 16 U.S.C. §§ 824d(e), 824e(b) and (d), 824h(b), 825(a).) This is not to say that the CPUC's representation of ratepayers at FERC is exclusive.[6]

Proceedings at FERC with respect to the Independent System Operator and the (now defunct) Power Exchange, to the extent that they involve rate making or rate design, are closely intertwined with the constitutionally conferred rate-making function. This amendment, however, would not compromise the CPUC's rate-making function because the FERC proceedings contemplated in this section encompass more that rate making or rate design. It gives the OEMO authority, not exclusive of the CPUC, to participate in FERC proceedings. Accordingly, we conclude that it is authorized by the reorganization statute.

2. June Draft Amendments to Public Utilities Code section 399.25, subdivision (a).

This proposal (see June Draft at p. 216), which is new in the June Draft, would transfer from the CPUC to the new Department of Energy responsibility for determining whether "an application of an electrical corporation for a certificate authorizing the construction of new transmission facilities . . . is necessary to facilitate achievement of the renewable power goals established in Article 16 (commencing with Section 399.11)." If the Department of Energy so finds, then that application "shall be deemed to be necessary to provision of electric service for purposes of any determination made under Section 1003 . . . ."

Public Utilities Code sections 1001 through 1013, to which this amendment refers, govern the requirements for construction or extension of facilities. These sections encompass the following provisions that are necessary and intrinsic to the rate-making function:

a) Section 1003, subdivision (c), requires, in connection with an application for certification, that the applicant utility submit "an appropriate cost estimate, including preliminary estimates of the costs of financing, construction, and operation, including fuel, maintenance, and dismantling or inactivation after the useful life of the plant, line or extension."

b) Section 1003, subdivision (d), requires, in connection with an application for certification, that the applicant utility submit "[a] cost analysis comparing the project with any

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[6] Although we are not informed of the full range of the CPUC's participation at FERC, this participation has not been limited to rate-making and rate-design proceedings. To the extent that the June Draft seeks to transfer from the CPUC the ability to participate in other kinds of FERC proceedings, it does not appear that section 12080.4, subdivision (e) would be an impediment.

feasible alternative sources of power. The corporation shall demonstrate the financial impact of the plant, line or extension construction on the corporation's ratepayers, stockholders, and on the cost of the corporation's borrowed capital. The costs analyses shall be performed for the projected useful life of the plant, line, or extension, including dismantling or inactivation after the useful life of the plant, line, or extension."

c) Section 1005, subdivision (b), provides: "When the [CPUC] issues a certificate for the new construction of a gas or electric plant, line or extension, the certificate shall specify the operating and cost characteristics of the plant, line, or extension, including, but not limited to, the size, capacity, cost, and all other characteristics of the plant, line, or extension which are specified in the information which the gas and electrical corporations are required to submit, pursuant to Section 1003 or 1003.5."

In its 1982 amendments to chapter five of the Public Utilities Code, which governs certificates of public convenience and necessity, the Legislature intended "[t]o provide the [CPUC] with sufficient reliable information to enable it to fulfill its functions to establish fair and equitable rates to cover prudent and reasonable costs incurred by electric and gas public utilities in the construction of electric and gas plants." (Stats.1982, c. 1253, § 1, subd. (c), p. 4595.[7])

In enacting Public Utilities Code section 399.25 in 2002, however, the Legislature subordinated the rate-making considerations in Public Utilities Code sections 1001 through 1013 to achieving renewable power goals. As a result, rate-making functions are not encompassed in the determination to be made under Public Utilities Code section 399.25, subdivision (a). We therefore find no impediment to transferring that function to the Department of Energy.

3. June Draft Amendments to Public Utilities Code section 399.25, subdivision (b).

This proposal (see June Draft at pp. 216-217), which is new in the June Draft, would give to the Department of Energy what is now the CPUC's responsibility for taking "all feasible actions to ensure that the transmission rates established by the Federal Energy Regulatory Commission are fully reflected in any retail rates established by the [CPUC]", with respect to transmission facilities described in subdivision (a).

Unlike the proposed amendment to subdivision (a) of Public Utilities Code section 399.25, discussed above, the proposed amendment to subdivision (b) would transfer explicit rate-

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[7] The 1982 enactment amended section 1005, added sections 1003 and 1003.5, and added article five, including sections 1091 through 1101, of the Public Utilities Code. (See Stats.1982, c. 1253.)

making functions from the CPUC to the Department of Energy. The reorganization process cannot be used to transfer this function from the CPUC to another agency, pursuant to section 12080.4, subdivision (e).[8]

4. June Draft Amendments to Public Utilities Code section 1001, subdivision (b).

This proposal (see June Draft at p. 235) would transfer from the CPUC to the exclusive jurisdiction of the Department of Energy "all responsibilities of the [CPUC] with respect to the certification of a natural gas line, storage facility, plant, or system, or any extension thereof, not owned by a public utility, and with respect to an electric transmission line, plant, or system, or any extension thereof, carrying electricity to the interconnected grid or that is part of the interconnected grid, but not including electric distribution facilities . . . . All applications for certification regarding a line, facility, plant, or system described in this subdivision shall be heard and decided by the California Energy Commission within the department. A decision of the department or the California Energy Commission with respect to matters transferred pursuant to this subdivision shall be conclusive as to all matters determined." Aside from several non-substantive changes, this June Draft proposal differs from the May Draft proposal by adding the words "not owned by a public utility" to qualify "certification of gas" et cetera.

There are in the June Draft two parts to this proposal. The first, respecting "certification of a natural gas line, storage facility, plant, or system, or any extension thereof, not owned by a public utility" does not fall within the CPUC's constitutional jurisdiction because of the limitation "not owned by a public utility." Accordingly, transfer of this function to the Department of Energy is authorized by the reorganization statute.

The second part of this proposal, relating to "an electric transmission line, plant, or system, or any extension thereof . . . ," does not contain a similar limitation and so falls within the CPUC's jurisdiction of public utilities.[9] Further, the responsibilities transferred include the cost recovery determinations set forth in chapter five of the Public Utilities Code. In light of the Legislature's explicit recognition that the provisions of chapter five of the Public Utilities Code (discussed in item 2, above) are designed specifically to help the CPUC fulfill its constitutionally conferred rate-making function (see Stats.1982, c. 1253, § 1, subd. (c), p. 4595), we conclude

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[8] This would be the correct conclusion, even if, as a matter of federal law, FERC determines these rates. Whatever authority remains to set retail rates in California different from rates set at FERC (and the proposal implies that there is some), the Constitution confers on the CPUC exclusively.

[9] See also discussion in footnote 8, *supra*.

that these functions cannot be transferred from the CPUC to the California Energy Commission under section 12080.4, subdivision (e).

5. June Draft Amendments to Public Utilities Code section 1001, subdivision (d).

This proposal (see June Draft at p. 236) would transfer from the CPUC to the California Energy Commission responsibility for considering and making "any necessary findings on all factors required by sections 1001 through 1005.5, inclusive, and any other provision of law, including the anticipated effect of any proposed project on consumer rates, on the environment, and on the public benefits expected to result from any project." The June Draft proposal is the same as the May Draft proposal to amend subdivision (c), save for re-designation as subdivision (d) and other, non-substantive changes.

The analysis of this June Draft proposal tracks that, above, of the second part of the proposed amendment to subdivision (b) of Public Utilities Code section 1001. This proposal would transfer from the CPUC to the California Energy Commission cost recovery determinations that the Legislature created to fulfill the rate-making function conferred on the CPUC by the California Constitution.[10] We therefore conclude that this proposal cannot be sustained under section 12080.4, subdivision (e).

The reorganization statute would permit those transfers of authority that do not interfere with the CPUC's exercise of its rate-making authority. For example, under the Warren-Alquist State Energy Resources Conservation and Development Act, the California Energy Commission has responsibility for the siting function for thermal energy plants and related transmission lines, but those responsibilities do not extend to the rate-making functions that are part of siting. (See Pub. Resources Code, §§ 25500, 25119, 25110, 25120, 25107; Pub. Util. Code, § 1002; *County of Sonoma, supra*, 40 Cal.3d 361, 364-365 & fn. 3.)

In summary, the reorganization statute prevents the transfer of constitutionally conferred rate-making authority from the CPUC to the jurisdiction and control of either the proposed Department of Energy or the California Energy Commission as contemplated by some of the proposals in the June Draft The reorganization process may be used, however, to transfer to

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[10] See also discussion in footnote 8, *supra*.

other agencies functions that do not compromise the CPUC's authority to set rates for public utilities.

Sincerely,

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Deputy Attorney General

For BILL LOCKYER
Attorney General